Opening Remarks of Damon Silvers

Congressional Oversight Panel Field Hearing on the Impact of Economic Recovery Efforts on Corporate and Commercial Real Estate Lending

May 28, 2009

Good morning. First let me express my thanks to New York University for hosting us today, to the staff for putting together what promises to be another highly informative hearing, and to my fellow panelist Richard Neiman for his hard work in putting this hearing together here in his home state.

This hearing is unusual in the brief history of the Congressional Oversight Panel. In each of our past field hearings, we have heard from American families—from homeowners, from small business people and community bankers, who have done much to educate the Panel as to the impact of the financial crisis and the Emergency Economic Stabilization Act, known to most Americans as the financial bailout. But today we hear from an S&P 500 company, one of our 25 largest banks, the Real Estate Roundtable, and the Federal Reserve Bank of New York.

Yet this witness list is entirely appropriate. One key measure of whether our financial system is functioning is whether large scale enterprises—be they firms or real estate development projects—can obtain financing on reasonable terms in relation to the risks they represent. If such financing is not available, then existing jobs disappear and new ones are never created. Innovation does not happen. Urban centers turn into parking lots and vacant lots. Investors liquidate and take losses on what should have been viable investments, adding to the downward pressure on our economy.

The financial crisis poses two threats of this kind. The first is the threat of a general loss of confidence in financial institutions and financial markets. We faced an acute threat of this type in September and October of this year, and judging by a number of measures, such as the persistence of historically high short term credit spreads, and the prolonged freeze in asset backed securities markets, fear in this area has not entirely gone away. This type of generalized fear can lead to both skyrocketing credit costs and the simple disappearance of liquidity from credit markets such that credit is not available at any price. However, thanks in part I believe to the actions taken under the Emergency Economic Stabilization Act, the threat of systemic breakdown has eased significantly.

The second threat though is much more specific. It is the threat posed not by a general loss of confidence, but by the actual weakness of key large financial institutions. This problem is more insidious because unlike a general credit crisis, it can be hidden—hidden by accounting tricks, hidden by compliant regulators, hidden even by well-meaning policymakers. But weak financial institutions in survival mode will not provide credit directly, and will not participate in asset backed securities markets. The resulting downward pressure on markets such as commercial real estate can lead to further weakening of bank balance sheets, resulting in a long term banking crisis feeding economic stagnation such as occurred in the 1990's in Japan.

And while we have seen the stress test results and the debates associated with those results, in a way, the real measure of the health of the banks is—are they playing their role in the credit system appropriately? What makes answering this question such a challenge is determining what constitutes appropriate credit provision in the context of a burst credit bubble and rapidly declining demand for credit. Appropriate credit provision is not the same thing as maintaining or reviving a bubble fueled by the collapse of underwriting standards.

The written testimony we have received for this hearing presents something of a paradox. On the one hand, we have the cautious optimism expressed by the written testimony of Mr. Schuermann from the Federal Reserve Bank of New York. On the other hand, the somewhat urgent warnings in relation to the commercial real estate market coming from Mr. Parkus at Deutsche Bank and to a lesser degree from Mr. DeBoer from the Real Estate Roundtable. And the Treasury Department's most recent bank lending survey, conducted in March, showed continuing contractions in bank lending in both commercial/industrial and commercial real estate.

Anecdotally, I hear from people in the real estate business that credit remains simply not available for large new projects or for refinancings. I also read stories like the account in the New York Times recently of the fate of Hartmarx, a significant New York state employer and the manufacturer of President Obama's suits. Wells Fargo, a major TARP recipient, was reported to be in a mode of favoring the certain lower returns and job losses associated with liquidation over the less certain higher returns and job preservation associated with a sale to a continuing operator.

I hope this hearing will sort out these paradoxes and help our Panel better understand the current state of business and commercial real estate credit markets and the role played in those markets by TARP recipient institutions both directly and indirectly through the ABS markets. I look forward to our witnesses' testimony.